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SUBJECT: KAZAKHSTAN: FATE OF LARGEST BANKS TO BE DECIDED
IMMINENTLY (PART 2 OF 3)

1. (U) Sensitive but unclassified. Not for public Internet.

2. (U) This is the second in a three-part series analyzing recent developments in Kazakhstan's banking sector, the possible future liquidation of its assets, and potential implications for international export credit agencies.

3. (SBU) SUMMARY: U.S. Department of Treasury Advisor Tom Lanier and International Economist in the Office of Europe and Asia Larry Norton visited Almaty and Astana June 10-13, 2009 to assess current conditions and trends in Kazakhstan's economy and the overall health of its financial sector. Lanier and Norton's interlocutors reported that Kazakhstan's Financial Supervision Agency (FSA) has ordered the country's largest private banks -- Alliance and BTA -- to submit proposals for the restructure of their foreign obligations to their international creditors. Officials at Alliance Bank are "nervous" about the outcome of their restructuring plans, and feel if any struggling bank were to be championed by the government, it would be BTA. Despite the banks' problems, depositor activity remains generally calm, and negotiations continue on the possible purchase of BTA by Sberbank of Russia. The banking sector's problems appear to be countered by the country's long-term investment potential, and macro-economic indicators suggest modest positive growth in Kazakhstan's GDP before the end of the calendar year. END SUMMARY.

PROGNOSIS FOR SUCCESSFUL RESTRUCTURE UNCERTAIN

4. (SBU) According to the Financial Supervision Agency, the three restructuring proposals for BTA and Alliance banks on the table are:

Option A - 20% immediate cash repayment at an 80% discount;
Option B - 50% repayment over seven years with 7% interest; and
Option C - 100% repayment over 15 years with 5% interest.

5. (SBU) ATF CEO Alexander Picker believes the three proposals are very wisely structured, and agrees that option three was likely designed for banks and international financial institutions that can accept nothing less than 100 percent repayment. According to

Citibank Kazakhstan's Dan Connelly, the general plan, should the need to liquidate arise, will be to first and foremost protect domestic depositors. He admitted that foreign bankers understood the risks and said that, "In the Kazakhstanis' position, I would probably do the same. They will however, ruin their reputation as being well regulated in the process." Connelly does not, however, believe that BTAs liquidation, should it come to pass, would have much of a systemic impact. "They will protect the depositors, give a big haircut to the foreign lenders, and then it will likely be a few years before the markets open to them again."

¶6. (SBU) According to Alliance Managing Director Gaziz Shakhanov, the outlook for Alliance is poor, and the government is not prepared to spend more than the \$4 billion it has already allocated to salvage Kazakhstan's commercial banks. Of this \$4 billion, Shakhanov said only a small portion would be available for a needed capital injection into Alliance. Detailing deposit outflows amounting to more than \$550 million since January, and just over \$75 million in May 2009, Shakhanov described the mood at Alliance as "nervous." This, he added was compounded by their view of BTA as a huge bank that continues to consume the government's limited anti-crisis resources. Citibank's Dan Connelly is not convinced that Alliance's days are numbered, but admits that the situation is rather bleak at best. "Their story never really jibed, but now that we see that the \$1 billion in treasury bonds was hocked! Deloitte was shocked. This stuff was buried. The markets were shocked by the news from Alliance." In the meantime, however, it is business as usual for Alliance "unless you have a lot of money stuck there."

¶7. (SBU) ATF CEO Picker believes that in a best-case scenario, six months from now, Alliance will have received a 75% acceptance rate from its creditors and successfully completed its restructuring, and

ASTANA 00001175 002 OF 002

BTA will have been purchased by Russia's Sberbank. Halyk Bank will still be going strong, according to Picker, and he believes that the political support behind NurBank will keep it solvent. "Kazkommertsbank (KKB) remains uncertain and I believe they too may soon start to default on smaller payments." He added, "My worst case scenario is that Alliance will go bankrupt, BTA will follow, and foreign financial institutions will be blamed."

CALM BEFORE THE STORM

¶8. (SBU) Despite the looming threat of liquidation, there has been surprisingly little public reaction. ATF CEO Picker said that even though it is very hard to withdraw large assets from BTA right now, he is amazed at the lack of a public outcry to the recent turn of events. "Three major banks have declared default and there seems to be no visible public reaction. There are no queues, no pickets, and no lines at the banks or ATMs. Even the international companies have not reacted." KKB's Executive Director Sergey Mokrousov said a group of German bankers recently told him that if the same situation were to happen in Germany, the entire banking system would likely collapse from the public's response. "In general, confidence in the banking sector has not diminished. This is very interesting for us," He explained. Some financial sector representatives have argued that the situation has not yet reached its tipping point. "There is some concern that if Alliance is not able to continue to serve its depositors, there will be a run on the banks across the board," said Managing Director Shakhanov.

WHERE ART THOU SBERBANK?

¶9. (SBU) Questions continue to circle around the possible purchase of BTA by the Russian state-owned savings bank Sberbank Rossii (Sberbank). Citibank's Dan Connelly believes the rumors are credible, given that "they can sort out BTA's Russian portfolio better than any others." Others believe the issue is more political than economic. ATF's CEO Picker said he believes there was a personal agreement made between President Nazarbayev and Sberbank Chairman German Greff. "Sberbank fits the bill, but it does not make sense economically," he argued. BTA's Pirmatov agreed that there is likely more to this deal than pure economics. "There is some kind of personal connection between Sberbank's Chairman Greff and Kairat Kelimbetov. Greff is originally from Karaganda, both are

former Ministers of Economy, and the initial announcement about Sberbank's interest was made the same day the government acquired control of BTA." Sberbank, Pirmatov added, also paid half of the fees for KPMG's audit of BTA. In the event that BTA does manage to secure creditor acceptance to restructure its debt, KKB's Mokroussov predicts that Sberbank will likely buy in, and Samruk-Kazyna will then sell 50 percent of its ownership stake, ultimately making BTA a viable financial institution.

MACRO CONDITIONS STABLE

¶10. (SBU) Leading indicators show that despite the fact that Kazakhstan's largest banks remain in financial limbo, the economy as a whole is holding steady and may realize positive growth later this year. The National Bank of Kazakhstan reported that GDP growth for all of 2009 will be 0%, but this figure may be revised upward in August depending on oil prices. ATF Bank's Alexander Picker said that there will be a 2.3% contraction for all of 2009, with a positive rebound of 2.3% in 2010. Squelching rumors of a further devaluation of the tenge, Picker described the February devaluation as "necessary and reasonable," and likely to hold without further measures needed. Citibank's Dan Connelly said his economists predict a contraction in the economy between 0.6 and 2.0 percent in ¶2009. However, some scenarios, he said, actually show a very slight amount of growth by the end of the year. The tenge devaluation, according to Connelly was "spot on and holding right where they said it would."

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